

Reg. §1.9741(14)-1 (Effective March 30, 1998) General statement of exemptions.

Title 32 V.S.A. § 9741(14) exempts from sales tax the purchase of tangible personal property which becomes an ingredient or component part of or is consumed or destroyed or loses its identity in the manufacture of tangible personal property for sale; machinery and equipment for use or consumption directly and exclusively in the manufacture of tangible personal property for sale or in the manufacture of other machinery or equipment, parts or supplies for use in the manufacturing process; and devices used to monitor manufacturing machinery and equipment or the product during the manufacturing process.

Reg. §1.9741(14)-2 (Effective March 30, 1998) Definitions.

(a) "Machinery and Equipment" means tangible personal property, capital in nature, with a useful life of one year or more, and does not include real property or supplies.

(b) "Manufacturing" means:

- (i) Industrial processing
- (ii) Food processing
- (iii) Mineral extraction
- (iv) Information processing

(c) "Industrial Processing" means an integrated series of operations, usually involving machinery and equipment, which changes the form, composition or character of tangible personal property by physical, chemical or other means.

(d) "Food Processing" means an integrated series of operations, usually involving machinery, which produces a distinct product for commercial distribution. Food processing includes, but is not limited to, coffee roasting, milk pasteurization, homogenization and bottling, meat and meat bi-products processing, beverage and water bottling, canning, freezing and the production of maple products. Farm or greenhouse operations, retail operations such as restaurants, grocery stores or butcher shops are neither "food processing" nor "industrial processing".

(e) "Mineral Extraction" means an integrated series of operations which extract deposits of ore, stone, sand and gravel or other naturally occurring deposits from the earth. Mineral extraction includes mine and quarry operations, water and oil wells and gravel pits. Excluded from mineral extraction are recovery operations from slag piles or grout piles or other process waste operations.

(f) "Information processing" means an integrated series of operations in which information or images are produced and sold as tangible personal property. Information processing includes the production of newspapers, pamphlets, books, computer software

(such as "canned" or "off the shelf" software), motion pictures and recorded audio and video tapes, CD ROMs and photographs. Information processing does not include the preparation of reports, documents, or statements, in a transaction in which tangible personal property is not the focus of the transaction.

(g) "Manufacturing Process" means:

(i) For industrial and food processing, the term "manufacturing process" means an integrated series of production activities beginning with the first production process and ending with the initial packaging of the product. If the product is not packaged, the manufacturing process ends with the last step that places the product in the form in which it is sold. Not included in the term "manufacturing process" are activities prior to the first production stage (such as collecting, weighing, testing, and bulk storage of raw materials) or any activities following initial packaging (such as secondary packaging, loading, delivery or transportation of finished goods following initial packaging to storage). The first production stage generally begins at the time the raw materials that are used or consumed in the manufacturing process are removed from storage. Thus, for example, conveyors, motorized lifts, cranes, chain falls and chemical, gas and electrical distribution systems constitute machinery and equipment used in the manufacturing process and would be exempt if used exclusively in such process.

(ii) For the mineral extraction process the term "manufacturing process" means a series of operations beginning with the removal of the mineral or overburden from the ground and ending with initial packaging and includes road construction within the quarry as long as the construction is a part of an integrated series of events leading to the extraction of mineral deposits.

(iii) For information processing operations, the term "manufacturing process" begins with the first direct steps in creating the text, image, tape or other product, through initial packaging. Excluded from the definition are management and accounting, research and other preparatory activities.

(h) "Initial Packaging" means the packaging used to reach the stage of containment most commonly received by the ultimate consumers of the product. In a case where a means of containment of a product is necessary before a continuation of the manufacturing process, initial packaging will be that stage in the process where the product is in the form in which retail consumption occurs. Initial packaging does not include freight cars, trucks, trailers or other such means of transportation even though the product has not undergone any prior packaging. Also excluded from initial packaging are pallets, shipping cartons, etc., that are used after initial packaging and cartons or other shipping materials applied to an otherwise unpackaged product at a location or time remote from the production of the product.

Reg. §1.9741(14)-3 (Effective March 30, 1998) Manufacturing supplies exemption.

(a) Ingredient or component. Tangible personal property which becomes an ingredient or component part of manufactured tangible personal property which will be sold by a manufacturer in the regular course of his business is exempt.

(b) Consumed or destroyed. Manufacturing materials and supplies consumed or destroyed in the manufacture of tangible personal property for sale are exempt. Tangible personal property which is purchased for use in the manufacture of tangible personal property for later sale and which has a normal life expectancy of less than one year in the use to which it is applied will be considered as expendable or as consumed or destroyed within the meaning of the exemption. The question of whether items are consumed or destroyed must be answered on the basis of the facts and circumstances pertaining to the use in question.

(i) "Life expectancy" means physical life expectancy as a usable item, not obsolescence. An article with a physical life expectancy of well over a year might become obsolete within a few months. Nevertheless, it would not be considered as consumed or destroyed within the meaning of the statute.

(ii) Property with a life expectancy of more than one year may be exempt as manufacturing machinery and equipment, in which case its exemption would rest on the direct and exclusive test.

(c) Maintenance supplies. Equipment and supplies, including soaps and cleaning compounds, brushes, brooms, mops and similar items, used for general cleaning and maintenance of manufacturing or processing property are not exempt from taxation.

(d) "In the manufacture of." This phrase shall be interpreted to exclude the periods before manufacture and after manufacture. Thus, the exemption does not extend to the procurement of raw materials except the extraction of mineral deposits and it does not extend to the storage and transportation of the finished product. Similarly, the exemption does not extend to administration, sales, advertising and other ancillary activities which are not an essential and integral part of the manufacturing process.

(e) Protective Clothing. Protective clothing will be considered exempt if worn to protect the integrity of the product, manufacturing process or the employee during the manufacturing operation.

Reg. § 1.9741(14)-4 (Effective March 30, 1998) Equipment, machinery or parts used directly and exclusively in manufacturing.

(a) General. The purchase of machinery and equipment is exempt from tax if such machinery and equipment is used directly and exclusively in the manufacture of tangible personal property for sale, in the manufacture of other manufacturing machinery and equipment, or in the manufacture of parts or supplies for use in the manufacturing process.

An electrical distribution system, including electrical switchgear, transformers, cables, and related equipment used to supply power to the machinery and equipment

that comprise the manufacturing process will be considered to be machinery and equipment used in the manufacturing process at the point they are dedicated to such process.

Machinery and equipment employed in preproduction or postproduction is not eligible for exemption. Machinery and equipment used in non-production activities such as safety, pollution or sound abatement, administration, general climate control, illumination, general wiring and waste control is not exempt.

(b) Direct Use.

(1) In determining whether machinery and equipment is directly used, the following factors are considered together with other relevant facts and circumstances:

(A) The active causal relationship which exists between the use of the machinery and equipment in question and the production of a product;

(B) Whether the machinery and equipment in question operates with an exempt machine or piece of equipment to complete or facilitate an integrated and synchronized system;

(C) Whether the machinery and equipment in question guarantees the integrity or quality of the manufactured product;

(D) The physical proximity of the machinery and equipment in question to the production process; lack of physical proximity by itself will not establish that a use is not direct.

(2) The fact that particular machinery or equipment may be considered essential to the conduct of the business of manufacturing because its use is required either by law or practical necessity does not, of itself, mean that the machinery or equipment is "used directly" in the manufacturing operation.

(A) Machinery or equipment used to test or inspect the product at any point during the production cycle or to monitor an activity occurring during the manufacturing process or the machinery or equipment used in the manufacturing process is considered to be directly used in a manufacturing operation.

(B) Machinery or equipment used in waste disposal is not deemed to be directly and exclusively used and is subject to tax except when the waste removal is necessary to protect the quality of the product and the waste removal is integrated into the manufacturing operations. Thus, machinery and equipment used for periodic cleaning of the production area in an operation not integrated into the manufacturing operation is not directly used in manufacturing and is taxable. Machinery and equipment used for treating or disposing of waste or handling of waste after it has been removed from the production area is not directly used and is taxable. Machinery and equipment used to evacuate gases and minerals from

the manufacturing process to guarantee the integrity of the process would be exempt.

(c) Exclusive use

The purchase or use by a manufacturer of machinery used directly and exclusively in manufacturing is exempt from tax. The following uses will not be considered to violate the exclusive use requirement:

(1) uses other than directly in manufacturing which are isolated or occasional provided that such uses are limited to no more than 4% of the time the machinery or equipment is operated;

(2) uses other than directly in manufacturing which are continuous or regular simultaneous uses or which exceed 4% of the time the machinery is operated, provided that no more than 4% of the output of the machinery or equipment is used for purposes other than directly in manufacturing;

(3) uses which are exempt under 32 V.S.A. § 9741(24) (commercial, industrial or agricultural research or development);

(4) uses which are exempt under 32 V.S.A. § 9741(25) (agricultural machinery and equipment).

(d) Not directly and exclusively used

(1) Generally, buildings and fixtures used to house manufacturing operations are not directly and exclusively used in manufacturing even if they are personal property. Personal property which is directly and exclusively used in the manufacturing process will not lose its exemption based on the fact that such property also houses the manufacturing process.

(2) Maintenance facilities, tools, equipment and supplies predominantly used in performing maintenance work are not exempt because maintenance or repair work is not manufacturing. Examples of such nonexempt items: chain hoists, tire spreaders, welding equipment, drills, sanders, wrenches, paint brushes and sprayers, oilers, absorbent compounds, dusting compounds, air blowers, wipers, and paint or other protective or decorative coatings are subject to tax. However, replacement parts which are used to replace worn parts upon exempt machinery and equipment, such as motors, belts, screws, bolts, cutting edges, air filters or gears, are exempt.

Reg. §1.9741(14)-5 (Effective March 30, 1998) Managerial, sales or nonoperational activities.

Tangible personal property, machinery or equipment used in managerial, sales or other nonoperational activities is not directly and exclusively used in manufacturing and is therefore subject to tax. This category includes, but is not limited to, tangible personal property, machinery and equipment used in any of the following activities:

(a) Manufacturing and administration. Office furniture, supplies, and equipment, textbooks and other educational materials, books and records, and all other tangible personal property including machinery and equipment used in record keeping and other administrative and managerial work, whether on or off the production line, is subject to tax. Such property includes, but is not limited to, supplies used to record the quality and quantity of work in production of goods in storage, the flow of work, the results of inspection, or to instruct workers in routing work or other production activities.

(b) Selling and Marketing. Tangible personal property, including machinery or equipment, used in advertising or marketing manufactured products for sale, transporting such products to a market or to customers, or selling such products, is not within the scope of the manufacturing exemption.

(c) Safety and fire prevention. Tangible personal property, including machinery or equipment used to prevent or fight fires and supplies used for promotion of safety, accident prevention or first aid, is subject to tax even if required by law.

Reg. §1.9741(14)-6 (Effective March 30, 1998) Space heating, cooling, ventilation and illumination.

Machinery and equipment used to ventilate a building, lighting for general illumination, air conditioning and other space cooling and space heating equipment, is subject to the tax. (See regulation 1.9741(34) for the treatment of fuel and electricity used for these purposes.)

Reg. §.9741(14)-7 (Effective March 30, 1998) Pre-production activities.

Tangible personal property, including machinery or equipment, used to transport personnel or to collect, convey, or transport tangible personal property and storage facilities or devices used to store or "hold" tangible personal property prior to its use in the first production stage are subject to tax. (See discussion of "first production stage" in 1.9741(14)-2(i).

Reg. §1.9741(14)-8 (Effective March 30, 1998) Post-production activities.

Tangible personal property, including machinery or equipment, used to transport or convey the finished product from the final manufacturing operation and storage facilities or devices used to store the product are not used directly in manufacturing and are taxable. For example, equipment which loads packaged products into cases or cartons for ease of handling in delivery is subject to tax. Machinery, equipment, supplies and other property used to convey, transport, handle or store the packaged product are also taxable.

Reg. § 1.9741(14)-9 (Effective March 30, 1998) Monitoring Machinery and Equipment.

Devices used to monitor manufacturing machinery and equipment or the product during the manufacturing process are exempt from tax. To be considered exempt as

monitoring equipment, the device must provide data necessary to maintain the integrity of the manufacturing process and tools. Excluded from this category are devices that are used primarily (more than fifty percent) to gather statistical data, provide security or surveillance of employees or provide inventory control.

Reg. §.9741(14)-10 (Effective March 30, 1998) Use of exemption certificates.

(a) Tangible personal property may be purchased by the manufacturer free of tax upon presentation to the vendor of a properly executed exemption certificate certifying that the purchase is for the purpose of manufacturing items for later sale. Exemption certificates are available from the Department of Taxes.

(b) Purchase by contractors. Structural components or buildings are not exempt machinery or equipment. Contractors should pay tax on all such purchases of materials used to alter or improve real property. Upon occasion a contractor may also supply machinery and equipment to manufacturers. In those instances, the contractor may buy such equipment tax free as a purchase for resale by furnishing their supplier with a properly executed exemption certificate.